CONNECTICUT CONFERENCE OF MUNICIPALITIES

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THE VOICE OF LOCAL GOVERNMENT

TESTIMONY

of the

CONNECTICUT CONFERENCE OF MUNICIPALITIES

to the

FINANCE, REVENUE AND BONDING COMMITTEE

March 15, 2010

CCM is Connecticut's statewide association of towns and cities and the voice of local government - your partners in governing Connecticut. Our members represent over 93% of Connecticut's population. We appreciate this opportunity to provide testimony to you on issues of concern to towns and cities.

CCM supports **SB 436, "AAC Municipal Revenue".**

This bill would allow municipalities to (1) levy, by ordinance, any type of tax, including **taxes on sales, food & beverages, amusements, hotels, payroll and hospital beds**, and (2) impose a **surcharge on any municipal fee set by statute up to the cost to the municipality of providing a specialized service.**

Local option taxes mean that the people who live and pay taxes in towns and cities would be able to decide best what mix of revenue sources work best for their community. That mix may not be the same in every municipality. In a state in which there is a clear over-dependence on property taxes to fund municipal services, and in an environment where financial help from the State will be limited it is time for Connecticut to consider allowing towns and cities (and/or regions) more flexibility and revenue diversity.

Connecticut statutes dictate that towns and cities are dependent on one tax — the property tax — for the vast majority of their revenue. But it's been clear for years that the property tax can no longer carry the burden by itself — it is a regressive tax that is not adequate for the task of funding local government services in the 21st Century.

Most States Allow Local Revenue Diversity

Only 15 states allow municipalities just the property tax.

- **23 states** allow at least some municipalities to levy both **property and sales taxes**
- **6 states** allow at least some municipalities to levy both **property and income taxes**, and
- **5 states** allow at least some municipalities to levy all three — **property, sales and income taxes**.
- Plus, remember that most other states have county governments that levy taxes in addition to state and local taxes, and that provide public services.
- When people consider moving to other states they often come back talking about how low the taxes are — but they are often referring to *property* taxes, the need for which is off-set by optional local taxes, county taxes and higher state income tax and sales tax rates.

- For example, of the 43 states with a personal income tax, 29 have income tax rates that reach higher than Connecticut's highest rate of 5%. They include states we typically think of as our economic competitors: North Carolina (7.75%), South Carolina (7%), Georgia (6%) and our neighbors New York (6.85%) and Massachusetts (5.3%).
- Those economic competitors have combined state/county sales tax rates that are higher than Connecticut's: North Carolina – 7.8%, South Carolina – 7.05%, Georgia – 6.95%
- Connecticut's property taxes are second highest in the nation.

Can Local Taxing Authority Work In Connecticut?

What works in other states may not work successfully in Connecticut. We're a small state, divided 169 ways. Other states are geographically larger, have unincorporated areas that get few services, and have county governments. One concern about granting municipalities the power to levy additional taxes is that municipalities that are poorer and have higher property tax rates will most likely be the ones that choose to levy additional taxes. In a small state like ours that might make the poorer/high tax communities even less competitive over time when it comes to attracting business investment, homeowners, etc. That would be counterproductive. **But inadequate state funding of non-education municipal aid is pushing more and more communities – particularly Connecticut's most distressed municipalities -- to look at local option taxes because of their desperate need for non-property tax revenues.**

Local Option Taxes

Local-option taxation allows citizens of the municipality to decide what mix of taxes works best for their community.

As proposed in the bill before you today, municipalities would be allowed to levy local-option taxes on sales, food/beverages and lodging as a way to take pressure off of property taxes. For example, locally levied sales taxes and hotel occupancy taxes would be able to be considered in municipalities where those industries are strong.

If every municipality were to enact a 1% sales tax – a highly unlikely event -- it would increase local revenue by $500 - $550 million. **Is there any other proposal out there that would deliver so much to relieve property tax pressures and continue local services?**

CCM estimates that a **1% tax on food and beverages would raise about $42 million statewide**, while a **3% lodging tax would raise** in the neighborhood of **$15-20 million**.

PILOT payments to municipalities for non-profit colleges and hospitals have fallen behind. Before budget cuts in 2003, municipalities were reimbursed for 73% of property mandated to be tax-exempt by the state…but just 54% now. Pequot-Mohegan grants, which also contain a PILOT factor in their distribution formula provided $135 million before 2003 cuts, just $62 million now. **A local-option hospital-bed tax would be a way, at no-cost to the State, to allow hard-pressed municipalities to recoup some of the revenue lost due to the state-mandated property tax exemptions and falling reimbursements.**

Other Approaches For Local Revenue Diversification

1. Make local taxes applicable statewide

One very straightforward approach would be for the State to add new sources of municipal revenue, but do so on a *statewide* basis. In this way all municipalities would be able to relieve pressures on the property tax, while avoiding any competitive harm that would arise if only certain municipalities applied the tax. For example, the State could authorize all municipalities to collect a local tax on lodging. The money would be kept by any municipality with a hotel, motel, B&B, etc. One attractive aspect of hotel taxes is that they export most of the tax to out-of-state visitors, rather than place the revenue burden on locals. Another example would be to raise the state sales tax and share the increase with towns and cities.

This piggyback approach makes administrative sense. There is precedent for applying local taxes on a statewide basis. The State already dictates that property taxes are the primary source of municipal revenue, and it applies the base municipal real estate conveyance tax evenly across all 169 municipalities.

2. Allow municipalities to assess alternative taxes on a regional basis

If alternative sources of local revenue were an option open to *regions* it would allow local elected officials, working with their neighbors, to levy the taxes that would fit best with their particular region. It would combine the advantages of local revenue enhancement while tailoring it to regional needs and avoiding negative competition between urban centers and suburbs. For example, a local-option sales tax might drive retail activity to the suburbs and away from cities, but an optional sales tax applied on a regional basis would not have the same effect — if the retailers want access to the market of a given region, the tax would apply no matter where they locate. Of course, regional consensus is sometimes difficult to reach, hence the allure of local-option authority and statewide application as discussed above.

CCM recommends that the State encourage the transition of all regional planning organizations (RPOs) into regional councils of government (COGs). Presently, there are three kinds of regional entities, one of which — regional planning agencies — comprise appointees and not elected officials. COGs are made up of chief elected officials — people who are accountable to the voters of their communities for their decisions. Any other type of regional entity would be inappropriate for greater fiscal authority. The State should enact an expedited process to encourage the transition of all regional organizations to COGs. Granting local-option taxing authority to COGs would not just diversify the municipal revenue base, it would be a major step towards increasing regional cooperation and thus improve overall governmental efficiency.

3. Share state revenues with municipalities or regions

Another way to diversify local revenue would be for the State to share portions of state revenue streams with municipalities. For example, the State could share a portion of the existing or increased sales tax with the municipalities or region in which the tax is collected. This would avoid the political and administrative travails associated with levying new taxes, although it would affect state revenue. However, the State could specify that municipalities receive all, or a portion of, any increases in state sales tax revenue above the levels anticipated in the present state budget. In that way, the State would never lose revenue, but towns and cities would stand to gain. The State could also use a piggyback approach (as discussed above) and share any increase in state taxes with towns and cities.

<u>Other Points For Consideration- Local Option Taxes</u>

Hotel/Lodging Tax:

- According to the Office of Legislative Research (OLR), our neighboring northeast states of Massachusetts, New Jersey, New York, Pennsylvania, Rhode Island, Vermont all allow some form of local hotel taxes.
- The "MORE" Commission recommended increasing the hotel tax by 3%, with 1/3 of the proceeds to go to host towns, 1/3 to all towns in host regions, and 1/3 for regional initiatives, like the Regional Incentive Performance Grant.
- Each percentage increase in the hotel tax raises, statewide, about $5 million - $7 million.
- Much of this increased revenue will come from non-Connecticut residents.

Sales Tax:

- Connecticut's **sales tax is lower than many in the northeast**, for example:
  --Massachusetts: 6.25%
  --Rhode Island: 7%
  --New York: 4%, but another 5% may be added by other taxing entities
  --Vermont: 6%, but local jurisdictions may add another 1%, the tax on prepared foods is 9% and 10% on alcohol served in restaurants
  --New Jersey: 7%
- Each percentage increase in the sales tax raises, statewide, about **$500 million - $550 million**
- Regional application of a sales tax avoids the type of intermunicipal competition that may arise from local-option taxes, it would avoid competition within a retail market to site facilities and grow local revenue because retailers seeking to serve a market would have the same rate no matter the town.
- Exemptions in Connecticut's sales tax system for things like food and prescriptions make it more progressive than many sales-based taxes

<u>Fees For Local Services</u>

SB 436, section 2 would also allow municipalities to **impose a surcharge on fees set by statute, up to the cost to the municipality** of providing the specialized service.

In many cases, fees for municipal services – set in statute – have not been increased in decades.

This proposal would treat local officials like adults, accountable to their residents, and would spare them the need to come to the Capitol to beg for fee increases that would enable them stay financially even.

It would not be *carte blanche* – the proposal is specific that surcharges could only be applied up to the cost to the municipality to provide the specialized service for which the fee is assessed.

Summary

What has worked for Connecticut before isn't working today. We need new approaches and new solutions as we meet the current economic and budgetary challenges.

If the State

- **chooses to ignore the need for increased non-property tax revenue at the local level,**
- **continues to cutback municipal aid,**
- **fails to encourage regional cooperation,**
- **again falls short on providing significant mandates relief**

the next few years look bleak.

The result will be:

- **higher property taxes**
- **fewer local services, and**
- **more lay-offs of municipal employees.**

Let's be honest with ourselves: that would be a policy choice – the wrong one.

We urge you to favorably report this bill.

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If you have any questions, please contact Jim Finley or Gian-Carl Casa of CCM, at (203) 498-3000.